INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statutes involved	2
Statement	2
Argument	6
Conclusion	11

CITATIONS

Cases:

American Power & Light Co. v. *Securities and Exchange Commission*, 329 U.S. 90	9
Associated Securities Corp. v. *Securities and Exchange Commission*, 293 F. 2d 738	9
Berko v. *Securities and Exchange Commission*, 316 F. 2d 137	10
In the Matter of Ernest F. Boruski, Jr. [1964–1966 Transfer Binder] CCH Fed. Sec. L. Rep. ¶77, 139 (S.E.C. Sept. 11, 1964), affirmed, 340 F. 2d 991, certiorari denied, 381 U.S. 943	9
Donaldson v. *Read Magazine, Inc.*, 333 U.S. 178	10
E. F. Drew & Co. v. *Federal Trade Commission*, 235 F. 2d 735, certiorari denied, 352 U.S. 969	10
Financial Counsellors, Inc. v. *Securities and Exchange Commission*, 339 F. 2d 196, certiorari denied, 381 U.S. 917	8
Gearhart & Otis, Inc. v. *Securities and Exchange Commission*, 348 F. 2d 798	8

288-897—68

Cases—Continued Page

Gilligan, Will & Co. v. *Securities and Exchange Commission*, 267 F. 2d 461, certiorari denied, 361 U.S. 896 ---- 8

Murray Space Shoe Corp. v. *Federal Trade Commission*, 304 F. 2d 270 ---- 10

Pierce v. *Securities and Exchange Commission*, 239 F. 2d 160 ---- 9, 10

Securities and Exchange Commission v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 ---- 7, 9, 11

Sunshine Anthracite Co. v. *Adkins*, 310 U.S. 381 ---- 11

Tager v. *Securities and Exchange Commission*, 344 F. 2d 5 ---- 8, 9

Ward Laboratories, Inc. v. *Federal Trade Commission*, 276 F. 2d 952, certiorari denied, 364 U.S. 827 ---- 7

Constitution, Statutes, and Rules:

United States Constitution:

First Amendment ---- 10, 11

Eight Amendment ---- 9

Investment Advisers Act of 1940, 54 Stat. 847, 15 U.S.C. 80b–1 *et seq* ---- 2

Section 201(3), 15 U.S.C. 80b–1(3) ---- 11

Section 203(d), 15 U.S.C. 80b–3(d) ---- 4, 8, 9

Section 204, 15 U.S.C. 80b–4 ---- 4

Section 206, 15 U.S.C. 80b–6 ---- 3, 11

Section 207, 15 U.S.C. 80b–7 ---- 4

Rules under the Investment Advisers Act of 1940, 17 C.F.R. 275.0–1 *et seq.*:

Rule 206(4)–1, 17 C.F.R. 275.206(4)–1 ---- 4

Rule 204–1, 17 C.F.R. 275.204–1 ---- 5

Miscellaneous:

II Loss, *Securities Regulation* (2d ed. 1961) ---- 9

S. Rep. No. 1775, 76th Cong., 3d Sess. ---- 7

In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 942

MARKETLINES, INC., PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 10–14) is reported at 384 F. 2d 264. The opinion of the Securities and Exchange Commission (Investment Advisers Act Release No. 206, January 20, 1967) (Pet. App. 15–29) is unreported.[1]

JURISDICTION

The judgment of the court of appeals was entered on October 9, 1967. The petition for a writ of certiorari was filed on December 22, 1967. The jurisdiction of this court is invoked under 28 U.S.C. 1254(1).

[1] A second Memorandum Opinion which denied a motion for reconsideration is also unreported.

QUESTIONS PRESENTED

1. Whether the Commission's findings that petitioner willfully violated the registration and antifraud provisions of the Investment Advisers Act of 1940 are supported by substantial evidence.

2. Whether in view of the serious nature of the violations found, and in view of the prior unlawful conduct of petitioner and its president, revocation of petitioner's registration as an investment adviser was a proper exercise of the Commission's discretion.

3. Whether petitioner has been denied its right to freedom of the press under the First Amendment to the Constitution.

STATUTES INVOLVED

The relevant provisions of the Investment Advisers Act of 1940, 54 Stat. 847, 15 U.S.C. 80b–1 *et seq.*, are set forth in Appendix D to the petition.

STATEMENT

Petitioner, Marketlines, Inc., was registered with the Securities and Exchange Commission as an investment adviser in January 1963. David Romanoff is the president, treasurer, and sole stockholder of petitioner. Harold Schreiber was vice-president and secretary of petitioner until his resignation from these offices in January 1965, after which he continued to be an employee of petitioner.

Between January 1, 1965, and July 15, 1965, petitioner solicited subscriptions to its market letters, "The Penny Speculator" and "Marketlines," through several advertisements in New York newspapers and through a mailed advertising brochure. The Commis-

sion held that petitioner's advertisements were "materially false and misleading," in violation of the anti-fraud provisions of Section 206 of the Investment Advisers Act, 15 U.S.C. 80b–6. The Commission found that the advertisements presented "a highly optimistic picture of the profits that would accrue to subscribers * * * [and] were materially misleading in failing to disclose the risks inherent in the purchase and sale of securities and were obviously designed to whet the speculative appetite of unsophisticated investors and thereby induce them to subscribe" (Pet. App. 18–19);[2] that the terminology used in the advertisements implied "that techniques for evaluating securities can be reduced to an exact science" and that the firm employed a large staff of financial analysts, when in fact the staff consisted solely of Romanoff and Schreiber (Pet. App. 19);[3] and that the references in the advertise-

[2] The Commission noted (Pet. App. 19–20):

> "The envelope [in which the brochure was mailed] proclaimed: 'AN INVITATION TO READ AN EXTRAORDINARY NEW CONCEPT IN MARKET PROFITS'; 'CAN YOU STRIKE IT RICH'; and 'MARKETLINES THE LETTER PROFESSIONALS READ.' The enclosed brochure stated in large type, 'Announcing The Most Revolutionary New Investment Concept To Come Along In Years—Giving You Invaluable Double Opportunity For Stock Market Profits.'"

[3] Advertisements placed in New York newspapers to solicit subscribers to "The Penny Speculator" stated that "interest in LOW PRICED STOCKS is opening profit possibilities that will undoubtedly pave the way for many family fortunes in the years just ahead"; and that Marketlines "has developed a completely unique advisory service," "backed by the research and experience" of Marketlines' "financial scientists and chartists" (Pet. App. 18).

ments to "timing devices," without disclosing the limitations of such devices, and to "free material," which could be obtained only with the purchase of a trial subscription, were expressly prohibited by the Commission's advertising rules promulgated under Section 206 (Pet. App. 19–20).[4]

The Commission also held that petitioner, aided and abetted by Romanoff, willfully violated the registration provisions of the Act[5] by (1) failing to amend

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[4] Rule 206(4)–1, 17 C.F.R. 275.206(4)–1, provides in pertinent part:

> (*a*) It shall constitute a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of section 206(4) of the Act, for any investment adviser, directly or indirectly, to publish, circulate or distribute any advertisement:
>
> * * * * * *
>
> (3) which represents, directly or indirectly, that any graph, chart, formula or other device being offered can in and of itself be used to determine which securities to buy or sell, or when to buy or sell them; or which represents directly or indirectly, that any graph, chart, formula or other device being offered will assist any person in making his own decisions as to which securities to buy or sell, or when to buy or sell them, without prominently disclosing in such advertisement the limitations thereof and the difficulties with respect to its use; or
>
> (4) which contains any statement to the effect that any report, analysis, or other service will be furnished free or without charge, unless such report, analysis or other service actually is or will be furnished entirely free and without any condition or obligation, directly or indirectly; or
>
> (5) which contains any untrue statement of a material fact, or which is otherwise false or misleading.

[5] Sections 203(d), 204, and 207 of the Act, 15 U.S.C. 80b–3(d), 80b–4, and 80b–7.

its registration application[6] promptly to disclose that Schreiber, who had been found in another Commission proceeding to have aided and abetted the violation of certain provisions of the Investment Advisers Act and of the Securities Exchange Act of 1934, was an employee of the firm,[7] and (2) failing to amend at all to disclose that Stanley Chandler, who had been found a violator in the same prior proceedings as Schreiber, was also associated with the firm (Pet. App. 21–22).

On the basis of its findings that petitioner had violated the antifraud and registration provisions of the Act and considering the prior unlawful conduct of

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[6] Rule 204–1, 17 C.F.R. 275.204–1, provides in pertinent part:

* * * * *

(*b*) *Amendment:* If the information contained in any application for registration filed on Form ADV, in any amendment filed on such form, or in any supplement filed on Form ADV–SUP, becomes inaccurate for any reason, the investment adviser shall promptly file an amendment on Form ADV correcting such information.

(*c*) *Report:* Every supplement and amendment required to be filed by a registered investment adviser under this rule shall constitute a "report" within the meaning of sections 204 and 207 of the Act.

[7] An amendment disclosing that Schreiber was an employee of petitioner was not filed until March 1965, three months after the Commission issued its findings concerning Schreiber's previous violations (Pet. App. 21–22). An amendment was filed in January 1965 to disclose that Schreiber had resigned as an officer, but despite the clear request for such information in the amendment form, this amendment did not disclose that Schreiber was to continue as an employee (see pp. 7–8, *infra*). The hearing examiner found that Schreiber continued to exercise a controlling influence over petitioner after his resignation as an officer (Pet. App. 21 n. 6).

Romanoff and petitioner,[8] the Commission held that it was in the public interest to revoke petitioner's registration as an investment adviser. On petition for review, the Court of Appeals for the Second Circuit affirmed *per curiam*.

ARGUMENT

The decision of the court below is correct, and the petition presents no question warranting further review by this Court.

1. Petitioner contends that the Commission improperly applied the "unsophisticated investor" test to determine whether its advertisements violated the antifraud provisions of the Act (Pet. 7–8). It is clear, however, that the Commission is charged with the responsibility of protecting the naive as well as the expert from deceptive practices. As the Senate Committee on Banking and Currency stated in its Report on the Act:

> The nature of the functions of investment advisers, their increasing widespread activities, their potential influence on security markets and *the dangerous potentialities of stock market tipsters imposing upon unsophisticated investors,* convinces this committee that protec-

[8] Romanoff had been convicted in 1950 in New York of conspiracy, second degree forgery, grand larceny, and concealment of stolen property, and had been disbarred as an attorney in that State. Marketlines had been barred from acting as an investment adviser in Illinois on the basis of findings that, in violation of the State's registration provisions, it had acted as an investment adviser both prior to filing an application for registration and after Romanoff had failed to score a passing grade on the State's investment adviser examination (Pet. App. 27–28).

> tion of investors requires the regulation of investment advisers on a national scale. [Emphasis added.] [9]

When advertisements are obviously aimed at unsophisticated investors, as they were in this case, it is appropriate to judge them by their impact on that segment of the public. See *Ward Laboratories, Inc. v. Federal Trade Commission,* 276 F. 2d 952 (C.A. 2), certiorari denied, 364 U.S. 827. The Commission's holding, moreover, was also based on its findings, which petitioner does not contest, that certain statements in the advertisements were expressly prohibited by the Commission's Rules.[10]

Petitioner also contends that the three-month delay in disclosing its employment of Schreiber was not unreasonable, and that its good faith was demonstrated by the fact that, promptly after Schreiber had been found to have violated the securities laws, it filed an amendment to disclose that he had resigned as an officer (Pet. 5, 8). As the court below found, however, (Pet. App. 13), there was not only a delay in disclosing that Schreiber was an employee, but as a result of the earlier amendment there was actual concealment of his association with the firm. No amendment at all would have been less deceptive than an amendment which disclosed that Schreiber was no

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[9] S. Rep. No. 1775, 76th Cong., 3d Sess., p. 21.

[10] Contrary to petitioner's argument (Pet. 7) that the Commission could not find a fraud violation because it "did not impute any intent by the petitioner to defraud or deceive," it is clear that a finding of intent to defraud is not required to establish a fraud violation under the Act. See *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195.

longer an officer but failed to state that he remained with the firm as an employee. Petitioner's argument that the three-month delay in disclosure constitutes only a minimal reporting violation fails to recognize the "vital importance [of the registration provisions] to the statutory scheme of securities regulations."[11] The delay in disclosure was particularly serious because Marketlines was only a two-man firm in which Schreiber played a major role in preparing the advisory material (R. 51–53). Petitioner's argument that Romanoff was unaware of the disclosure requirement is refuted by the record,[12] and even if true, would be no defense to the violations found. See *Tager* v. *Securities and Exchange Commission,* 344 F. 2d 5, 8 (C.A. 2).[13]

2. The revocation of petitioner's registration as an investment adviser was a proper exercise of the Com-

[11] *Financial Counsellors, Inc.* v. *Securities and Exchange Commission,* 339 F. 2d 196, 197 (C.A. 2), certiorari denied, 381 U.S. 917. Section 203(d) of the Act provides that if the Commission finds it to be in the public interest, it shall deny registration to, suspend, or revoke the registration of an investment adviser if "any person directly or indirectly * * * controlled by such investment adviser" has, *inter alia*, "willfully violated any provisions of the Securities Act of 1933, or of the Securities Exchange Act of 1934, or of this title * * *" or "has aided [or] abetted * * * the violation by any other person * * *" of any of these provisions.

[12] The standard amending form signed by Romanoff clearly stated the requirement of disclosing the name of any employee who had been found to have violated the securities laws (R. 408).

[13] Accord, *Gilligan, Will & Co.* v. *Securities and Exchange Commission,* 267 F. 2d 461 (C.A. 2), certiorari denied, 361 U.S. 896; *Gearhart & Otis, Inc.* v. *Securities and Exchange Commission,* 348 F. 2d 798, 802–803 (C.A.D.C.).

mission's discretion.[14] Advertisements of the type used by Marketlines tend to deceive the public and to debase the standards of the investment advisory industry. And the concealment from the Commission of the identity of employees who have previously violated the securities laws impedes enforcement of the Act. Considering these specific violations and also the Illinois bar order against Marketlines and the New York conviction and disbarment of Romanoff,[15] the Commission appropriately determined that it would not be in the public interest for petitioner to continue to be a member of a profession in which it is essential that the highest ethical standards prevail.[16] Contrary to petitioner's argument that the sanction imposed by the Commission was a "cruel and unusual punishment" in violation of the Eighth Amendment,

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[14] *American Power & Light Co.* v. *Securities and Exchange Commission*, 329 U.S. 90, 112–113; *Tager* v. *Securities and Exchange Commission*, 344 F. 2d 5, 8–9 (C.A. 2); *Pierce* v. *Securities and Exchange Commission*, 239 F. 2d 160, 163 (C.A. 9); *Associated Securities Corp.* v. *Securities and Exchange Commission*, 293 F. 2d 738, 741 (C.A. 10).

[15] Petitioner asserts (Pet. 7) that the Commission considered "extraneous evidence," apparently referring to the bar order and conviction. While these factors could not, under Section 203(d) of the Act, serve as an independent basis for denial, suspension or revocation of registration as an investment adviser, the Commission may consider them in determining the appropriate sanction to be imposed "in the public interest." See *In the Matter of Ernest F. Boruski, Jr.*, [1964–1966 Transfer Binder] CCH Fed. Sec. L. Rep. ¶77,139 (S.E.C. Sept. 11, 1964) affirmed, *Boruski* v. *Securities and Exchange Commission*, 340 F. 2d 991 (C.A. 2), certiorari denied, 381 U.S. 943, 944; II Loss, *Securities Regulation*, 1303 n. 52 (2d ed. 1961).

[16] *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. at 186, 191, 193, 194, 201.

it is well recognized that revocation is a remedial action to protect the public and does not constitute punishment.[17]

3. Only one of petitioner's constitutional arguments—that the use of an "unsophisticated investor" test to judge advertising violates the First Amendment—has ever been urged at any prior point in these proceedings. It is clear, however, that the First Amendment does not require the Securities and Exchange Commission, any more than it does the Federal Trade Commission[18] or the Postmaster General[19] to limit the application of the antifraud provisions of its laws to those advertisements which would mislead persons who are knowledgeable in a given field. As this Court stated in *Donaldson* v. *Read Magazine, Inc.*, 333 U.S. 178, 189:

> Questions of fraud may be determined in the light of the effect advertisements would most probably produce on ordinary minds. * * * People have a right to assume that fraudulent advertising traps will not be laid to ensnare them. 'Laws are made to protect the trusting as well as the suspicious.'

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[17] See *Berko* v. *Securities and Exchange Commission*, 316 F. 2d 137, 141 (C.A. 2); *Pierce* v. *Securities and Exchange Commission*, 239 F. 2d 160, 163 (C.A. 9).

[18] *Murray Space Shoe Corp.* v. *Federal Trade Commission*, 304 F. 2d 270, 272 (C.A. 2); *E. F. Drew & Co.* v. *Federal Trade Commission*, 235 F. 2d 735, 739–740 (C.A. 2), certiorari denied 352 U.S. 969.

[19] *Donaldson* v. *Read Magazine, Inc.*, 333 U.S. 178, 188–190, 191.

Petitioner's remaining constitutional arguments are not properly before this Court, and in any event are without merit.[20]

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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JANUARY 1968.

[20] Petitioner urges (Pet. 6, 7) that it is an abridgement of its rights under the First Amendment to impose a sanction which precludes it from publishing its investment advisory material. But the First Amendment does not restrict Congress' constitutional authority to impose reasonable qualifications of honesty and integrity for participation in a profession which has a substantial effect upon the national securities markets (see Section 201(3) of the Act, 15 U.S.C. 80b–1(3) (Pet App. 31)), and which, as this Court recognized in *Securities and Exchange Commission* v. *Capital Gains Research Bureau Inc.*, *supra* note 16, involves a fiduciary relationship.

Nor is there any merit to petitioner's argument that Congress has empowered the Commission to create antifraud rules without providing reasonable standards. See Section 206(4) of the Act, 15 U.S.C. 80b–6(4), authorizing rules and regulations to "define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative." See also *Sunshine Anthracite Co.* v. *Adkins*, 310 U.S. 381, 398.

U.S. GOVERNMENT PRINTING OFFICE: 1968